FEDERAL AGRICULTURAL IMPROVEMENT AND REFORM (FAIR) ACT
SELECTED PROVISIONS AND INTERPRETATION

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The FAIR farm and food bill has been passed by the U.S. Congress and signed by the President. Key provisions are highlighted below, with special emphasis on the provisions relating to commercial agriculture. We also include some initial thoughts on implications and the bigger policy picture.

Caveat: this is only our interpretation of the general provisions of the bill. We may not fully understand some provisions. Furthermore, these provisions have to be implemented through administrative rules not yet formulated.

INCOME PAYMENTS: PRODUCTION FLEXIBILITY CONTRACTS

- A 7-year production flexibility contract (1996-2002 crops) with guaranteed annual payments is established for wheat, corn, sorghum, oats, barley, rice, and cotton.

- Subject to several adjustments, annual spending on production flexibility contracts is set at:

1996	$5.57 billion
1997	$5.39 billion
1998	$5.80 billion
1999	$5.60 billion
2000	$5.13 billion
2001	$4.13 billion
2002	$4.01 billion

- Payments are allocated among crops as follows:

corn	46.22%
wheat	26.26%
upland cotton	11.63%
rice	8.47%
sorghum	5.11%
barley	2.16%
oats	0.15%

- Payments to individual producers for a crop will be based on the individual's payment quantity [his/her program yield (frozen at 1985 program levels) times 85% of contract acreage] times a payment rate [total spending level for the commodity for the specific year divided by total payment quantity].

- Eligibility for the production flexibility contract for a crop is established by

⇨ Having one or more crop acreage base(s) on the land,
⇨ Participation in at least 1 of the 1991-1995 crop year programs,
[All land in CRP prior to January 1, 1996 is eligible for a production flexibility contract]
⇨ Meeting conservation compliance and other environmental requirements such as wetland protection, and
⇨ Staying within planting flexibility requirements (see below).

- Signup for the new program will begin approximately 45 days after enactment and extends through August 1, 1996.

- Annual contract payments are to be made no later than September 30 of each Fiscal Year. A producer may elect to receive a 50% advance payment on December 15 or January 15 of the Fiscal Year. For 1996, a 50 percent payment will be available within 30 days of signup.

- Beginning with the 1996 Spring planted crop, crop insurance no longer is required to establish eligibility for farm programs, including production flexibility contracts, provided the producer agrees in writing to waive any eligibility for federal disaster assistance for the waived crop.

- The Secretary of Agriculture is required to establish a "business interruption" insurance program allowing producers to purchase revenue insurance coverage to protect them from revenue losses caused by low prices or poor yields. The present set of insurance programs is retained, including catastrophic crop insurance.

- A person can receive no more than $40,000 in contract payments (previous limit was $50,000). The 3-entity rule which allows farmers to double the limit is maintained.

NONRECOURSE MARKETING ASSISTANCE LOANS

- Marketing assistance loans are established for barley, corn, cotton, oilseeds (including soybeans), oats, rice, sorghum, and wheat for the 1996-2002 crops. These loans may be repaid at the lesser of (a) the established loan rate or (b) prevailing price adjusted to U.S. quality and location to make U.S. commodities competitive in the world market. In lieu of a marketing loan, a producer may take a loan deficiency payment where the producer pockets the price difference without first putting the crop under loan.

- Eligibility for marketing loans or loan deficiency payments for barley, corn, cotton, oats, rice, sorghum, and wheat is conditional on eligibility for the production flexibility contract. Marketing loans or loan deficiency payments are available for all production of a crop for which a farmer has a production flexibility contract.

- For extra long staple cotton and oilseeds, all production is eligible for marketing loans or loan deficiency payments.

- For corn and wheat, the marketing loan rate is 85% of the preceding 5-year average prices, excluding the high and low prices, but it can not exceed $2.58/bu. for wheat and $1.89/bu. for corn.

- The marketing loan rate for wheat and corn can be reduced by (a) 10% if the stocks-to-use ratio exceeds or equals 30% for wheat and 25% for corn and (b) 5% if the stocks-to-use ratio is between 15 and 30% for wheat and 12.5 and 25% for corn.

- The soybean marketing loan rate is set at 85% of the preceding 5-year average prices, excluding the high and low prices; but it can not be less than $4.92/bu. nor more than $5.26/bu.

- Marketing loans for corn, soybeans, and wheat are for no more than 9 months.

- Each person can receive no more than $75,000 in marketing loans and loan deficiency payments per year. This limit can be doubled by subdivision.

- The limit on all subsidies, including marketing assistance loan subsidies and production flexibility contract payments, is $230,000 per recipient.

PLANTING FLEXIBILITY

- Acreage reduction programs (ARPs) and paid land diversion (PLDs) are eliminated.

- 0/85/92 and 50/85/92 programs are eliminated.

- Fruits and vegetables cannot be planted on production flexibility contract acres.

- All other crops, including lentils, mung beans, and dry peas, can be planted on all contract acreage. Year-round haying, including alfalfa, and grazing are permitted on all contract acreage.

OTHER PROVISIONS

The FAIR bill:

- Continues the permanent laws of 1938 and 1949. Their provisions will become effective if a new farm bill is not enacted in seven years and if Congress does not repeal the permanent laws.

- Immediately ends the budget assessment on dairy producers. Support prices on butter, powder, and cheese are phased down over four years from $10.35/cwt to $9.90/cwt in 1999. At the end of 1999, price support authority is eliminated and a 3-year recourse loan program to processors is initiated at $9.90/cwt. Federal milk marketing orders are to be consolidated from 33 to 10-14 in three years. A New England dairy compact is authorized, but it can be implemented only if the Secretary of Agriculture finds compelling public interest to do so. The Compact ends when the new price formulas and marketing order systems are implemented.

- Freezes loan rates at the current $0.18/lb for raw cane sugar and $0.229/lb for refined beet sugar. Unless imports exceed 1.5 million short tons, the loans are recourse, not nonrecourse, loans. The penalty for loan forfeitures is one cent per pound. Marketing allotments are eliminated.

- Essentially maintains the current peanut program, but lowers the support rate for quota peanuts from $678/ton to $610/ton. The floor on the national poundage quotas is eliminated.

- Reauthorizes food aid to developing countries, the wheat security commodity reserve, food for progress, export credit guarantee, Market Access Program (MAP) (formerly called Market Promotion Program), and export enhancement (EEP) programs. MAP is restricted to small businesses, farmer-owned cooperatives, and agricultural groups. Maximum funding for MAP is $90 million/year. The Dairy Export Incentive Program is reauthorized at limits consistent with the GATT.

- Eliminates the Emergency Livestock Assistance Program.

- Eliminates the Farmer-Owned Reserve (FOR) Program.

- Increases the interest rate on Commodity Credit Corporation agricultural commodity loans by 100 basis points.

- Limits the Conservation Reserve Program (CRP) to 36.4 million acres (previously, more acres were allowed but CRP never exceeded 36.4 million acres). An early out provision is provided for CRP by allowing an owner or operator to terminate a CRP contract with 60 days written notification except on lands that are deemed to be of high environmental value. Funds saved by termination of contracts may be used to enroll new land.

- Reauthorizes the Wetland Reserve Program (maximum of 975,000 acres) and environmental cost share/technical assistance.

- Authorizes an Environmental Quality Incentives Program (EQIP) to assist (cost share) farmers in adopting environmentally friendly practices. Crop and livestock enterprises are eligible. Assistance to individual operations is capped at $10,000/year for a maximum of 5 years over the seven year life of this program. Large operators, as defined by the Secretary of Agriculture, are ineligible.

- Extends the food stamp program is extended for two years.

- Authorizes $300 million dollars to purchase land to assist in restoring the Everglades.

- Authorizes a $300 million fund for Rural America for three years. The money is to be used for rural development and research.

Observations

Although the new farm bill began as a battle over budgetary cost of commodity programs, the proposed farm legislation may cost more than would extending the 1990 farm legislation over the next seven years. While the new farm programs will probably cost less in 2002 than current programs, the budget was not the sole motivator. A desire for change was important, and the favorable current crop supply/demand conditions provided a window of opportunity. The new bill was sold as a package that would (a) allow farmers to respond to markets and be globally competitive, (b) provide more generous payments at least for 1996 and 1997 than extending the 1990 farm bill, and (c) be a buydown to end provision for ARPs immediately. Other observations follow.

- The farm bill immediately ends supply controls (ARPs) and presumably will end income transfers (production flexibility contract payments) from taxpayers to producers after year 2002. Safety net stabilization (marketing assistance loans and crop insurance) and environmental features (including CRP) are retained and are likely to remain after year 2002. The latter observation along with the retention of the permanent legislation argue that, at present, the bill is best thought of as a buydown to a lower safety net.

- Producers retain crop or revenue insurance and loan supports paid by the government. Marketing loans and loan deficiency payments perform like deficiency payments, but this bill reduces the income support price on corn, for example, from $2.75 to no more than $1.89 per bushel. Adding this 31% drop to another 20% for inflation (assuming 2.6%/yr.), and the corn real support price is cut in half during the bill's life.

- Although permanent law is continued, the traditional rationales are dead. The farm bill debate rarely mentioned the family farm, small farms, and food security — traditional rationales for commodity programs. The debate was about commercial agriculture and the bill reflects this.

- Between 1991 and 1995, many small farms did not participate in farm programs though eligible. Many large farms produce commodities that are not covered by commodity programs. If they produce program commodities, they are subject to payment limits. Thus the new program will continue to provide considerably more payments per dollar of farm receipts to mid-size than to small farms or large farms. Although large farms receive more absolute benefits per farm from programs, mid-size farms receive the most relative benefits (payments per receipts) and hence will be most disadvantaged by the program phase-down.

- For consumers, the government no longer accumulates buffer stocks nor sets aside acres as a strategic reserve for food security except for the CRP and small emergency Food Security Commodity Reserve. Nonrecourse loans that resulted in forfeiture of crops to the government and hence to CCC stock accumulation are being replaced by marketing assistance loans. These changes will add to farm price/quantity variability and reward those who successfully manage risk.

- Except for a few restraints on planting, elimination of acreage restriction programs unleashes competition, meaning farmers can plant or not plant subject to market incentive and the few remaining planting flexibility constraints. Based upon farmer's response to the 15% flex acre provision in the 1990 farm bill, substantial shifting of acres among crops and even idling acres can be expected. This will be further enhanced by the ability to hay and graze year around on all contract acreage. States which border the Mississippi and Ohio rivers appear to be the big gainers in forthcoming regional shifts in field crop production.

- The bill continues the trend to environmental protection and enhancement as the rationale for farm programs. Over time, the federal government has expanded the concept of environmental protection from soil conservation to water quality to wildlife habitats to protection of farmland from development. The Farms for the Future Program provides $35,000,000 to preserve farmland from commercial development. Besides the limit on planting fruits and vegetables, conservation compliance and wetlands protection are the only eligibility criteria that affect contemporary production practices. Thus, the production flexibility contract payments can be thought of as green payments. In addition, there are many other environmentally related programs, including the Environmental Quality Incentives Program and the purchase of farmland to assist in restoring the Everglades. In short, this is a very pro-environmental bill.

KEY UNANSWERED POLICY QUESTIONS

- How great will economic instability be? The government will continue to provide risk protection but with less income enhancement to producers. The buffer reserve of food security provided by ARPs, FOR, and CCC stocks will be gone. Marketing assistance loans and termination of the Farmer Owned Reserve are designed to take the government (CCC) out of owning or holding buffer stocks between years. Will the private sector provide sufficient buffer stocks and risk shifting tools to satisfy the needs of producers and consumers?

- What will be the impact of quantity instability? Without land set-asides and only limited government stocks, quantity instability could become a greater problem for post-farm gate agribusinesses than price instability. One solution could be greater private stocks held by both elevators and processors, which now should be thought of as including large livestock farms. Another could be production contracts between processors and crop farmers in the surrounding areas. If the latter approach is utilized, vertical contracting could quickly become the norm among field crops.

- Will farmers overproduce? The temptation for optimism with the new farm bill and currently favorable crop prices needs to be tempered. Farms have capacity to produce in excess of what the market can absorb at current prices. A concern is that transitory high crop prices coupled with sizable payments in 1996 and 1997 will unduly inflate land prices and will cause some farmers to overextend themselves financially, creating conditions for a shakeout in later years. History teaches and economics strongly predicts that, as long as productivity increases continue, real farm commodity prices in the future will be lower than they are today. This observation suggests farmers should prepare themselves for long-term prices that are closer to the new marketing loan prices than current target prices, let alone today's high market prices.

- Will low farm prices sometime during the life of the 1996 farm bill cause the government to reverse itself, reestablishing crop set asides, stock accumulation, and/or deficiency payments? Another outcome could be raising loan rates. High marketing loan rates create more overproduction than the previous deficiency payments because the loan subsidies are coupled to current output.

- How will including *feed* grains in the emergency reserve promote *food* security? The Food Security Wheat Reserve is renamed the Food Security Commodity Reserve to reflect that corn, rice, and sorghum are added as eligible commodities. A 4 million metric ton cap is retained on the reserve. The emergency wheat reserve has especially benefited poor countries — the only countries unable to purchase food security through imports when world food supplies are tight.

- Will sugar, tobacco, and peanut policy survive after the next 7 years? These programs exist to enhance farmer's income, but this rationale has not saved the other programs. Perhaps if these programs embrace environmental reasons for existence they will avoid joining honey and wool/mohair as historical footnotes.

- What happens to the ethanol tax subsidy? A key argument for this subsidy has been that the subsidy increases demand, which in turn increases price and reduces deficiency payments. With the income support rate reduced below current free market price levels and with most payment now fixed, this argument loses some of its appeal. Will new arguments emerge?

- What is the appropriate long-term role of government in agriculture? An 11 member Commission on 21st Century Agriculture is established. It will monitor the impact of market transition contracts and by January 1, 2001 will make recommendations regarding the appropriate role of the federal government in production agriculture.

- Will farmers now embrace environmental quality as the rationale for farm programs? The strongest intellectual argument for continued government involvement in agriculture is to protect the environment from nonpoint source externalities. Is it politically feasible to take a program historically designed to raise commercial farm income and efficiently target it to environmental needs? Society has already determined that farmers will be regulated on environmental practices. Farmers can determine by their collective decisions and actions whether they are paid for the regulation or not paid. The challenge will be to make programs inclusive of environmental needs, targeted, effective, efficient, and administratively feasible. If farmers accept the environmental rationale, gain and cotton direct (production flexibility contract) payments may be continued after 2002 as incentives to use environmentally friendly practices.